

# **MARYLAND HEALTH CARE COMMISSION**

## **Determining the Threshold for Required Approval of Changes in Certificate of Need Approved Capital Cost**

The Maryland Health Care Commission (“MHCC”) administers Maryland’s Certificate of Need (“CON”) program, which requires certain capital projects of health care facilities to obtain approval by MHCC. Regulations at COMAR 10.24.01.17 specify that certain changes in projects that have received CON approval require review and approval by MHCC. Among the changes in CON-approved projects that require MHCC review and approval is the incursion of *“capital cost increases that exceed the approved capital cost inflated by an amount determined by applying the Building Cost Index in Healthcare Cost Review from the application submission date to the date of the filing of a request for approval of a project change.”*

Thus, persons with a CON are required to obtain approval from MHCC for increases in the capital cost of CON-approved projects that exceed a specific cost increase threshold. Under the above-referenced regulation, that threshold is now determined through use of a specific inflation index, published on a quarterly basis by IHS Global Insight in *Healthcare Cost Review* as part of its Health Care Costs Individual Price and Wage Indexes. The Building Cost Index (BCI) that will be used by MHCC and which should be used by applicants evaluating the threshold requiring approval for their capital cost increases is the most recently published “CMS New 2006-Based PPS

Hospital Capital IPI.”<sup>1</sup> The allowable inflation increase in approved capital cost, i.e., the cost increase that does not require Commission approval unless exceeded, can be determined through use of the “%MOVAVG” statistic for this index. Following are two examples:

**EXAMPLE 1: Calculating Inflation for a Period Including Full Years**

For a project with:

- 1) A current capital cost of \$10,000,000, as of the date of application submission (exclusive of any allowance for inflation in the final capital cost of the project);
- 2) An application submission date of May 1, 2006; and
- 3) A cost modification date of May 1, 2008 (2 years).

**STEP 1 – Calculate Inflation Factor for the First Year**

- A) Find the correct inflation index percentage for the first year, 2007, by going to the most recent “Table 5, Individual Price and Wage Indexes: National Forecasts” in *Healthcare Cost Review*, “Building Cost Indexes.” (Use the “CMS New 2006-based PPS Hospital Capital IPI” and the line for “%MOVAVG.” The correct inflation index percentage is found on this line under the column labeled “2007:2” (Year 2007, Second Quarter). The index percentage is 1.2. Calculate the inflation factor for the first year by converting the index percentage to a decimal and adding 1.0.  $[.012 + 1.0 = 1.012]$

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<sup>1</sup> Prior to the First Quarter 2008 Edition of *Health Care Cost Review*, MHCC used the “CIS Proxy for the ENR” building cost index. Publication of this index in *Health Care Cost Review* ended, beginning with the First Quarter 2008 Edition. At the point, MHCC began using the “HCFA Old 1997 Based Hospital IPI” building cost index and used it through February, 2010. Publication of this index ended in *Healthcare Cost Review*, beginning with the Fourth Quarter 2009 Edition.

**STEP 2 – Calculate Inflation Factor for the Second Year**

- A) Find the correct inflation index percentage for the second year, 2008, by going to “Table 5, Individual Price and Wage Indexes: National Forecasts” in *Healthcare Cost Review*, “Building Cost Indexes.” Use the “CMS New 2006-based PPS Hospital Capital IPI” and the line for “%MOVAVG.” The correct inflation index percentage is found on this line under the column labeled “2008.02” (Year 2008, Second Quarter). The index percentage is 1.4
- B) Calculate the inflation factor for the second year by converting the index percentage to a decimal and adding 1.0.  $[.014 + 1.0] = 1.014$

**STEP 3 – Calculate Inflation Factor for the Full Two Year Period**

Multiply the inflation factor for the first year by the inflation factor for the second year.

$$[1.012 \times 1.014] = 1.0262$$

**STEP 4 – Calculate the Allowable Increased Capital Cost (i.e., the Project Cost which will not require Commission approval unless exceeded)**

Multiply the inflation factor for the full two year period by the current capital cost of the project, exclusive of any inflation allowance, as of the date of application submission.

$$[1.0262 \times \$10,000,000 = \$10,262,000]$$

## **EXAMPLE 2: Calculating Inflation for a Period Including Part of a Full Year**

For a project with:

- 1) A current capital cost of \$10,000,000, as of the date of application submission (exclusive of any allowance for inflation in final capital cost of the project);
- 2) An application submission date of May 1, 2006; and
- 3) A cost modification date of September 1, 2008 (2 years, 4 months)

### **STEP 1 – Calculate Inflation Factor for the First Year**

- A) Find the correct inflation index percentage for the first year, 2007, by going to the most recent “Table 5, Individual Price and Wage Indexes: National Forecasts” in *Healthcare Cost Review*, “Building Cost Indexes.” Use the “CMS New 2006-based PPS Hospital Capital IPI” and the line for “%MOVAVG.” The correct inflation index percentage is found on this line under the column labeled “2007:02” (Year 2007, Second Quarter). The index percentage is 1.2.
- B) Calculate the inflation factor for the first year by converting the index percentage to a decimal and adding 1.0.  $[.012 + 1.0 = 1.012]$

### **STEP 2 – Calculate Inflation Factor for the Second Year**

- A) Find the correct inflation index percentage for the second year, 2008, by going to “Table 5, Individual Price and Wage Indexes: National Forecasts” in *Healthcare Cost Review*, “Building Cost Indexes.” Use the “CMS New 2006-based PPS Hospital Capital IPI” and the line for “%MOVAVG.” The correct

inflation index percentage is found on this line under the column labeled “2008:02” (Year 2008, Second Quarter). The index percentage is 1.4.

- B) Calculate the inflation factor for the second year by converting the index percentage to a decimal and adding 1.0.  $[.014 + 1.0 = 1.014]$

**STEP 3 – Calculate Inflation Factor for the Remaining Half Year**

- A) Find the correct inflation indexes for the remaining four months, June, 2008-September, 2008, by going to “Table 5, Individual Price and Wage Indexes: National Forecasts” in *Healthcare Cost Review*, “Building Cost Indexes.” Use the “CMS New 2006-based PPS Hospital Capital IPI” and use the “CAPB06” line. The inflation index found on this line for the beginning quarter of the four-month period is under the column labeled “2008:02” (Year 2008, Second Quarter) and is 1.031. Next, the inflation index for the ending quarter of the four-month period is found under the column labeled “2008:03” (Year 2008, Third Quarter) and is 1.034.

- B) Calculate the inflation factor for the remaining four month period by dividing the “2008.3” index by the “2008.2” index.  $[1.034 / 1.031 = 1.003]$

**STEP 4 – Calculate Inflation Factor for the Twenty-Eight Month Period**

Multiply the inflation factor for the first year by the inflation factor for the second year by the inflation factor for the remaining partial year.

$$[1.012 \times 1.014 \times 1.003 = 1.0292]$$

**STEP 5 – Calculate the Allowable Increased Capital Cost (i.e., the Project Cost which will not require Commission approval unless exceeded)**

Multiply the inflation factor for the twenty-eight month period (2 years, four months) by the current capital cost of the project, exclusive of any inflation allowance, as of the date of application submission.

$$[1.0292 \times \$10,000,000 = \$10,292,000]$$

The publication containing this index, *Healthcare Cost Review*, is issued on a quarterly basis and can be purchased from IHS Global Insight, 800-933-3374 or 781-301-9200 [support@globalinsight.com].

The “Building Cost Indexes”, as reported in the current issue of *Healthcare Cost Review, FIRST-QUARTER 2009*, published by IHS Global Insight, are as follows:

Year: Quarter	CMS New 2006-based PPS Hospital Capital IPI	%MOVAVG
2006:3	1.005	1.1
2006:4	1.008	1.2
2007:1	1.009	1.2
2007: 2	1.016	1.2
2007:3	1.018	1.0
2007.4	1.022	1.3
2008:1	1.024	1.4
2008:2	1.031	1.4
2008:3	1.034	1.5
2008:4	1.039	1.5
2009:1	1.040	1.6

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2009:2	1.045	1.5
2009:3	1.046	1.4
2009:4	1.049	1.3
2010:1	1.051	1.1
2010:2	1.055	1.0
2010:3	1.057	1.0
2010:4	1.061	1.1
2011:1	1.063	1.1
2011:2	1.068	1.1
2011:3	1.071	1.2
2011:4	1.076	1.3
2012:1	1.079	1.4
2012:2	1.084	1.4
2012:3	1.087	1.5

For further information about use of this inflation adjustment statistic, contact Paul E. Parker, Chief, Certificate of Need, at MHCC, (410)764-3261.